



**RISK
ADVISORY
UPDATE**

Internal Audit and Its Importance for the Business

Introduction

The demand for both external and internal auditing is sourced in the need to have some means of independent verification to reduce record-keeping errors, asset misappropriation, and fraud within the business and non-profit organizations.

Brief History

- Historians have traced the roots of internal auditing to centuries B.C., as merchants verified receipts for grain brought to market. The real growth of the profession occurred in the 19th and 20th centuries with the expansion of corporate business. Demand grew for systems of control in companies conducting operations in many locations and employing thousands of people.
- It also has its genesis in the era of the Maurya dynasty where Kautilya, a 4th century B.C.E. economist, recognized the importance of accounting methods in economic enterprises. The internal audit specifically was first made mandatory for a particular set of companies vide the Manufacturing and Other Companies (Auditor Report) Order, (MAOCARO, 1975). With the advent of the Companies Act 2013 and regulations being undergoing dynamic changes on daily basis, the demand for professionalism, knowledge, and integrity has increased manifold.

Importance of internal audit in business:

I. Basics of Business

- Before skipping directly to why the internal audit is one of the most important aspects of a successful business it is crucial to understand the basics of what the term '**Business**' really means and what is the perspective of an entrepreneur/business.
- Business in its most basic sense, is the process of developing a solution to a problem faced within society and commercializing the solution to generate wealth, and employment, and be a valuable addition to a problem-stricken society. It involves the organization of a diverse palette of resources that can deal with an unpredictable external environment to achieve a common goal. These resources are broadly categorized as:
 - Financial Resources: Funding.
 - Human Resources: Employees.
 - Educational Resources: Industry Know-How.
 - Physical Resources: Premises and Equipment.

II. Role of Internal Audit:

- To efficiently and effectively achieve its goals and objectives an organization/business needs to optimize the utilization of its resources, and that is exactly where the role of fields such as accountancy, financial analytics, and our respected field of auditing comes in.

- As an organization grows and expands (which every organization eventually aims to) the nature of resources and the external environment that an organization deals with becomes more complex and routine checks become almost mandatory to ensure that the entity is being able to optimize the utilization of resources and further complies with the relevant laws and rules formulated by the government.
- While the statutory audit is compulsory and a routine activity for any company, the importance, and benefits of an internal audit outweigh the cost of an internal audit. Internal audit is not mandatory, and it is the choice of the management of the company to get it done by its internal auditors however management does not want to be red-faced in case of any irregularities when the statutory audit is conducted which is why, to keep a check on the operations of the company, internal audit is done.
- An internal auditor (IA) is a trained professional employed by companies to provide independent and objective evaluations of financial and operational business activities, including corporate governance. They are tasked with ensuring that companies comply with laws and regulations, follow proper procedures, and function as efficiently as possible.



III. Why every business needs an internal audit

- I. All organizations should have an internal audit function; however, the structure and size of the internal audit function will vary greatly depending on the size and complexity of the organization. The role of an internal audit is to provide independent assurance that an organization’s risk management, governance, and internal control processes are operating effectively. The Institute of Internal Auditors defines the internal audit process this way:

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

- II. Many organizations outsource or co-source the internal audit function to a third party to maximize budget and efficiency, and have a professional team performing these services. The key point is that every organization needs to have an internal audit function, to ensure:
 - Confidence in the organization’s ability to meet its core business goals.
 - Save organization time and money and keep everything running like a well-oiled machine.
 - Protecting the enterprise against fraud and preventing fraudulent practices.
 - Reduction in risks to your operations, finances, cybersecurity, and other areas of concern.
 - Compliance with the laws, regulations, and standards that apply to your organization – and reduction in costs and hassle when external auditors test your compliance; or
 - To the board of directors and audit committee that the entity’s internal controls and business processes are functioning as they should.

- III. Some key benefits of having an internal audit function are:
- a) Strong internal controls
 - b) Spotting redundancies in business practices, procedures, and policies
 - c) Reducing the risk of fraud
 - d) Improved compliance

Internal audit creates value by identifying organization-wide risks, leveraging synergies, monitoring, improving early warnings of new risks, and improving processes and efficiency. Partnering with a professional service provider for internal audit projects or as an outsourced team, allows you to evaluate your current internal audit function or internal controls environment and development strategies to strengthen your organization to help reduce risks of fraud or material error, maximize operational effectiveness, and identify opportunities to maximize profits.

IV. Summary

In summary, an internal audit is an integral part of your organization's overall success, no matter your organization's size or structure – non-profit, private, or public company. You may not have a formal internal audit department, but you can still take advantage of completing a full organization risk assessment and performing internal audit procedures to receive the benefits of an internal audit that work both within your preferred timeframe and budget.

Common questions and queries regarding internal audit

1. How Do Internal Audits Provides Objective Insight?

You can't audit your work without having a definite conflict of interest. Your internal auditor, or internal audit team, cannot have any operational responsibility to achieve this objective insight. In situations where smaller companies don't have extra resources to devote to this, it's acceptable to cross-train employees in different departments to be able to audit another department. By providing an independent and unbiased view, the internal audit function adds value to your organization.

2. How Do Internal Audits Improve the Efficiency of Operations?

By objectively reviewing your organization's policies and procedures, you can receive assurance that you are doing what your policies and procedures say you are doing and that these processes are adequate in mitigating your unique risks.

By continuously monitoring and reviewing your processes, you can identify control recommendations to improve the efficiency and effectiveness of these processes. In turn, allowing your organization to be dependent on processes, rather than people.

3. How Do Internal Audits Evaluate Risks and Protect Assets?

An internal audit program assists management and stakeholders by identifying and prioritizing risks through a systematic risk assessment. A risk assessment can help to identify any gaps in the environment and allow for a remediation plan to take place.

Your internal audit program will help you to track and document any changes that have been made to your environment and ensure the mitigation of any found risks.

4. How Do Internal Audits Assess Controls?

Internal auditing is beneficial because it improves the control environment of the organization by assessing efficiency and operating effectiveness. Are your controls fulfilling their purpose? Are they adequate in mitigating risk?

5. How Do Internal Audits Ensure Compliance with Laws and Regulations?

By regularly performing an internal audit, you can ensure compliance with all relevant laws and regulations. It can also help provide you with peace of mind that you are prepared for your next external audit. Gaining client trust and avoiding costly fines associated with non-compliance make internal auditing an important and worthwhile activity for your organization.